REPORT OF EXAMINATION
OF THE

ZNAT INSURANCE COMPANY

AS OF
DECEMBER 31, 2005

Participating State
and Zone:

California

Filed November 30, 2006

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Los Angeles, California
November 1, 2006

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Gary L. Smith
Secretary, Zone IV-Western
Director of Insurance
Department of Insurance, State of Idaho
Boise, Idaho

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Director and Commissioner:

Pursuant to your instructions, an examination was made of the

ZNAT INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 21255 Califa Street, Woodland Hills, California 91367.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2001. This examination covers the period from January 1, 2002 through December 31, 2005. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. The examination included a review of the Company’s practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances.

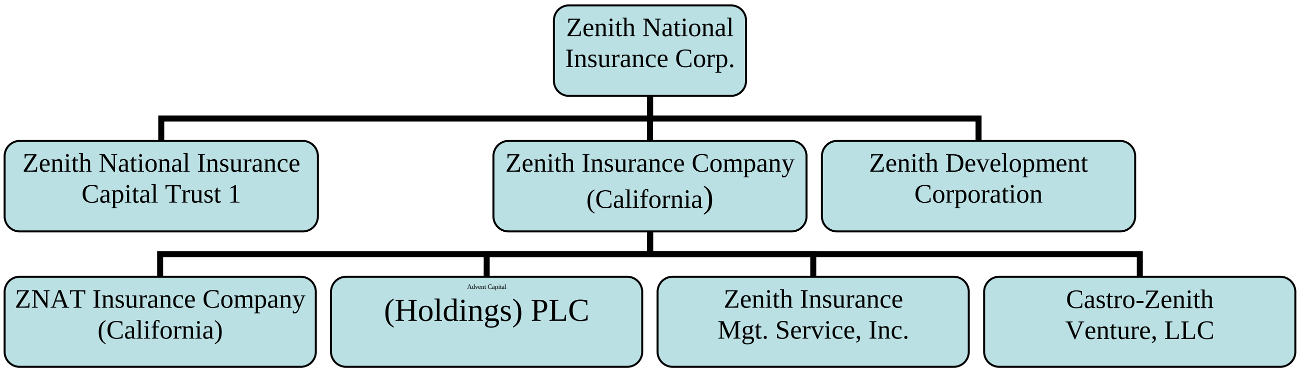
The examination was conducted concurrently with the examination of the Company's parent, Zenith Insurance Company.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records and sales and advertising.

MANAGEMENT AND CONTROL

As of the prior examination date, Fairfax Financial, through its subsidiaries, owned 42% of the Company's parent, Zenith National Insurance Corp.'s (Zenith National), common stock. At December 31, 2005, companies controlled by Fairfax Financial owned 3.8 million or 10.3% of the total outstanding shares of common stock of Zenith National. On February 7, 2006 Fairfax Financial sold all of the 3.8 million shares and no longer owns shares of Zenith National common stock.

The following abridged organizational chart, which is limited to the Company's parent along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



All of the above entities are 100% owned by their parent except for Advent Capital (Holdings), PLC which is 10% owned by the Zenith Insurance Company and Castro – Zenith Venture, LLC which is 50% owned by Zenith Insurance Company.

Management of the Company is vested in a three-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2005 follows:

Directors

Name and Residence	Principal Business Affiliation
Stanley R. Zax Beverly Hills, California	Chairman of the Board and President Zenith National Insurance Corp.
William J. Owen Los Angeles, California	Senior Vice President and Chief Financial Officer Zenith National Insurance Corp.
Jack D. Miller Los Angeles, California	Secretary Zenith National Insurance Corp.

Principal Officers

Name	Title
Stanley R. Zax	Chairman of the Board
Jack D. Miller	President
William J. Owen*	Senior Vice President and Treasurer
Hyman J. Lee, Jr.	Vice President and Secretary

(*) resigned effective June 30, 2006, replaced by Kari L. Van Gundy

Management Agreements

Cost Allocation Agreement: Since 1991, Zenith National Insurance Corp. (Zenith National) and its insurance subsidiaries are parties to a cost allocation agreement with the Company. Under the terms of the agreement, costs of shared facilities, services, and expenses are allocated to each party on a cost allocation basis. During the years 2002, 2003, 2004, and 2005, the Company paid approximately $2.3 million, $500,000, $1.5 million, and $6.5 million, respectively. The increase in fees paid during 2005 was reflective of the increase in direct premiums written (and related increased costs) by the Company during 2005.

Tax Sharing Agreement: As amended during 1999, the Company and certain affiliates are parties to a tax sharing agreement. The agreement provides for participants to file a consolidated federal income tax return with Zenith National. Allocation of taxes is based upon separate return calculations with inter-company tax balances settled in the quarter subsequent to the filing of the consolidated return.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2005, the Company was licensed to transact multiple lines of property and casualty insurance in Arkansas, California, Iowa, Texas, and Utah.

In 2005, the Company wrote approximately $49.5 million of direct premiums. Of the direct premiums written, $43 million (87%) were written in California and the remaining premiums were written in Texas (13%).

The principal line of business written is workers' compensation, which amounted to approximately 99% of the Company's total premiums written.

The Company's business is written through approximately 1,404 brokerage firms and independent agencies. The Company and its parent maintain branch offices in San Diego, San Francisco, Pleasanton, Sacramento, Fresno, Glendale, and Orange, California. Additionally, the Company maintains branch offices in Austin, Texas; Blue Bell, Pennsylvania; Springfield and Lisle, Illinois; Sarasota, Orlando and Hollywood, Florida; Charlotte, North Carolina and Birmingham, Alabama.

REINSURANCE

Intercompany Pooling Agreement

The underwriting operations of the Company, and its insurance affiliates, are governed by an Intercompany Pooling Agreement (Agreement). The Agreement provides for the pooling and distribution, in fixed percentages, of the companies' underwriting operations, liabilities, expenses, income, and losses directly related to the writing of insurance contracts. Excluded from the purview of the Agreement are intercompany balances, real estate expenses, investment income and expenses, and directors' fees and similar expenses.

Zenith Insurance Company (Zenith) is the lead insurer in the pool. Under the terms of the Agreement, the Company cedes to Zenith 100% of its net retained underwriting liabilities. Zenith retrocedes to the Company its proportionate shares of all the underwriting liabilities ceded to Zenith. Members of the pool and their respective participation percentages as of year-end 2005 were as follows:

Pool Member	Percentage
Zenith Insurance Company	98%
ZNAT Insurance Company	2%
Total	100%

All parties to the Agreement are named participants in all reinsurance agreements with non-affiliated reinsurers, and have a contractual right of direct recovery from the non-affiliated reinsurers.

Assumed

The Company's assumed business is limited to its participation in the above referenced pooling agreement.

Ceded

As of year-end 2005, the Company maintained excess of loss and catastrophe reinsurance protection on its direct workers' compensation writings as follows: Excess of loss reinsurance covering losses, per occurrence, in excess of $1,000,000 up to an aggregate loss of $150 million. The following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2005:

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
First – Fourth Layer	100% Employers Reinsurance Corporation	$1,000,000	$9,000,000 Excess of $1,000,000
Fifth Layer	30.36% Various Lloyd's of London Syndicates 18% Hannover Rueckversicherungs- AG 14.5% XL Reinsurance America Inc, 12.5% Endurance Specialty 34.64 Various reinsurers	$10,000,000	$10,000,000 Excess of $10,000,000
Sixth Layer	12% Hannover Rueckversicherungs- AG 12% Swiss Re America Corp. 76% Various reinsurers	$20,000,000	$20,000,000 Excess of $20,000,000
Seventh Layer	19.60% Various Lloyd's of London Syndicates 80.34% Various reinsurers	$40,000,000	$35,000,000 Excess of $40,000,000

Type of Contract	Reinsurer(s) Name	Company's Retention	Reinsurer's Maximum Limits
Eighth Layer	17.70% Employers Reinsurance Corporation 15.00% Swiss Re America Corp. 13.00% Ace Tempest Reinsurance Limited 12.50% Axis Specialty Limited 12.50% Endurance Specialty	$75,000,000	$75,000,000 Excess of $75,000,000

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001 through December 31, 2005

Statement of Financial Condition
as of December 31, 2005

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 35,559,150	$	$ 35,559,150	
Cash and short-term investments	28,141,829		28,141,829	
Receivable for securities	181,250		181,250	
Investment income due and accrued	426,165		426,165	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	519,197	37,351	481,846	
Premiums, agents' balances and installments booked but deferred and not yet due	800,123	24,308	775,815	
Amounts recoverable from reinsurers	94,604		94,604	
Funds held by or deposited with reinsured companies	312,274		312,274	
Other amounts recoverable under reinsurance contracts	45,467		45,467	
Net deferred tax asset	1,891,000		1,891,000	
Guarantee funds receivable or on deposit	301,667		301,667	
Aggregate write-ins for other than invested assets	23,169		23,169	
Total assets	$ 68,295,895	$ 61,659	$ 68,234,236	

Liabilities, Surplus and Other Funds			
Losses		$ 23,928,814	(1)
Reinsurance payable on paid losses and lae expenses		48,654	
Loss adjustment expenses		5,267,124	(1)
Commissions payable		267,245	
Other expenses		176,395	
Taxes, licenses and fees		619,271	
Current federal and foreign income taxes		955,000	
Unearned premiums		2,468,810	
Advance premiums		85,885	
Ceded reinsurance premiums payable		133,362	
Funds held by company under reinsurance treaties		12,555	
Payable to parent, subsidiaries and affiliates		20,730,125	
Aggregate write-ins for liabilities		4,677,748	
Total liabilities		59,370,988	
Aggregate write-ins for special surplus funds	$ 214,828		
Common capital stock	3,120,000		
Gross paid-in and contributed surplus	380,000		
Unassigned funds (surplus)	5,148,420		
Surplus as regards policyholders		8,863,248	
Total liabilities, surplus and other funds		$ 68,234,236	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income		
Premiums earned		$ 23,574,000
Deductions:		
Losses incurred	$ 10,142,046	
Loss expense incurred	3,935,335	
Other underwriting expenses incurred	6,027,890	
Total underwriting deductions		20,105,271
Net underwriting gain		3,468,729
Investment Income		
Net investment income earned	$ 1,437,370	
Net realized capital gains	96,145	
Net investment gain		1,533,515
Other Income		
Net loss from agents' balances charged off	$ (74,611)	
Total other loss		(81,847)
Net income before dividends to policyholders and before federal income taxes		4,927,633
Dividends to policyholders		79,876
Federal income taxes incurred		1,949,000
Net income		$ 2,898,757

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2004		$ 10,247,440
Net income	$ 2,898,757	
Change in deferred income tax	638,000	
Change in nonadmitted assets	7,027	
Aggregate write-ins for gains and losses in surplus	(4,927,976)	
Change in surplus as regards policyholders		(1,384,192)
Surplus as regards policyholders, December 31, 2005		$ 8,863,248

Reconciliation of Surplus as Regards Policyholders
from December 31, 2001through December 31, 2005

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2001, per Examination			$ 5,301,955
Net income	$ 6,909,573	$	
Change in unrealized foreign exchange capital gain	913,000		
Change in deferred tax asset	302,640		
Change in nonadmitted assets	497,368		
Aggregate write-ins for losses in surplus		5,061,288	
Totals	$ 8,622,581	$ 5,061,288	
Net increase in surplus as regards policyholders for the examination			3,561,293
Surplus as regards policyholders, December 31, 2005 per Examination			$ 8,863,248

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based upon a review conducted by a Casualty Actuary from the California Department of Insurance, the Company's reserves for losses and loss adjustment expenses as of December 31, 2005, after consideration of the reserve established pursuant to California Insurance Code (CIC) Section 11558, were found to be reasonably stated.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Losses and Loss Adjustment Expenses (Page 12): It was recommended that the Company review its methods for allocating loss adjustment, other underwriting and investment expenses when preparing the Underwriting and Investment Exhibit (Part 4) of the Annual Statement. The examiners reviewed the methods for allocating loss adjustment, other underwriting and investment expenses and it appears that the expenses are properly allocated.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Constance J. Korte, CFE
Examiner-In-Charge
Department of Insurance
State of California